No. 11626

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

LILY HO QUON and ALBERT T. QUON,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Upon Petition to Review Decisions of the Tax Court of the United States

---

REPLY BRIEF FOR PETITIONERS.

GEORGE T. ALTMAN,
215 West Seventh Street, Los Angeles 14,
Attorney for Petitioners.

Parker & Company, Law Printers, Los Angeles. Phone TR. 5206.

TOPICAL INDEX

TABLE OF AUTHORITIES CITED

CASES. PAGE

No. 11626

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

LILY HO QUON and ALBERT T. QUON,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

REPLY BRIEF FOR PETITIONERS.

I.

Respondent's Restatement of Facts Erroneously Conveys the Impression That the Tax Court Found as a Fact That the Partnership Was a Mere Sham.

Respondent, in restating the facts as found by the Tax Court, labels the partnership as "purported", "alleged", "so-called." (Br. 6, 7, 9.) Nowhere in the Tax Court's findings of fact is any one of those words used. To this extent respondent's statement may be adroit; but it is clearly misrepresentative.

The term "purported" is indeed used in the opinion; but the references made by the Tax Court to the partnership there are not even pretended to be findings of fact based upon evidence. The Tax Court there in speaking of

what it has found to be fact refers back to what is contained in its findings of fact; and its conclusions with respect to the partnership stated in its opinion are predicated expressly upon those findings of fact. The Court in no wise represents these conclusions as being such findings, but presents them on the contrary as conclusions following as a matter of law from its findings.

Thus, the Tax Court in its opinion [R. 39] refers to its finding of a purpose to avoid the freezing of assets, and then states that that purpose is not the proper kind in their judgment to indicate an "intent to really and truly join together for the purpose of carrying on business as partners." It is made no finding at all with respect to such intent. It only drew an opinion in regard to it as a matter of law from a fact clearly found, a fact uncontroverted in the record and now before this Court. *Commissioner v. Heininger,* 320 U. S. 467. There is no rule which requires this Court to close its eyes to the reasoning of the Court below.

II.

Respondent's Summary of Argument Erroneously Interprets a Question of Law to Be a Question of Fact.

Respondent in his summary of argument makes the same error as he did in restating the facts. He states there: "the Tax Court has found that no valid partnership exists under the facts and that finding is supported by the evidence." (Br. 11.) The Tax Court made no such finding. Nor could it. The facts being found, the question whether or not validity results is a question of law, not of fact.

III.

The Dobson Rule Is Inapplicable Here.

Respondent in his argument first attempts to apply the *Dobson* rule. (Br. 11.) That rule has no application here. As respondent himself points out, the facts found by the Tax Court have not been controverted by the taxpayers. (Br. 15.) The facts are therefore not in controversy and there is no issue of fact raised here. The only issues before this Court are the conclusions of law of the Tax Court stated in its opinion. Those conclusions are reviewable here. *Commissioner v. Heininger, supra,* decided on the same day as the *Dobson* case; *Crane v. Commissioner,* 15 U. S. Law Week 4455 (decided April 14, 1947).

In the *Heininger* case the question was whether legal expense incurred in protecting a business from destruction as a result of charges of illegal acts was an "ordinary and necessary" expense of the business. The Tax Court treated the question as a question of law and decided against the taxpayer. Appeal was taken to the Circuit Court, which reversed the Tax Court's holding. The case reached the Supreme Court, where the Circuit Court's decision was sustained. Of course, the *Dobson* rule was inapplicable. The striking feature of the *Heininger* case was that the question which was heard on appeal was whether protection of a business from destruction was a normal business purpose. That legal issue is presented in this case and will be further discussed in this brief.

IV.

Respondent Quotes the Tower Case, Yet He Completely Fails to Show a Single Finding of Fact Which, as His Quotation Requires, Negatives Bona Fides on the Part of the Petitioners.

Respondent reaches the heart of the problem when he quotes from the *Tower* case. (Br. 14.) As that quotation shows, the true question is whether there was a real intention to carry on business as a partnership. That intention of the parties, as respondent's quotation from the *Tower* case indicates, is to be "determined from testimony disclosed by their 'agreement, considered as a whole, and their conduct in execution of its provisions'." As respondent also points out (Br. 15), the agreement is in the record; and the Tax Court's findings of fact show what the conduct was in execution of its provisions. Does respondent point out any clause in the agreement, or any statement of the Tax Court in its findings of fact with respect to the conduct of the parties in execution of its provisions, which shows anything but a *bona fide* intention to carry on business as a partnership? Respondent has quoted from the *Tower* case but has failed to point to any specific portion of the findings of fact to which that quotation is intended to bear reference.

V.

The Purpose to Protect the Business From Destruction Is a Normal Business Purpose. Not Only Is It Consistent With But in Fact Confirms Bona Fides of the Partnership Here.

Respondent stresses the conclusion of the Tax Court that the purpose to prevent disruption or destruction of the business through seizure of the assets by the Government is not the kind of a business purpose essential to a valid partnership for income tax purposes. (Br. 16, 19.) The Supreme Court of the United States has held, however, that prevention of destruction of a business is a normal business purpose. *Commissioner v. Heininger, supra,* affirming C. C. A. 7, 133 F. (2d) 567. The question there, as already observed above, was whether a legal expense incurred in protecting a business from destruction was ordinary and necessary. The Circuit Court in that case stated:

> "We think that where an expense is incurred which saves the life of a business, even for a time, it is, in the light of the above interpretation, not only a business expense, but a necessary business expense. Without the expenditure, there would have been no income in this case because there would have been no business. The business depended directly upon the expense incurred in the litigation. We therefore hold that the expense was both ordinary and necessary."

And the Supreme Court stated:

> "For respondent to employ a lawyer to defend his business from threatened destruction was 'normal'; it was the response ordinarily to be expected."

It would indeed be odd if anyone faced with destruction of his business failed to make an attempt to save it. Does that make the act done for that purpose any the less complete and *bona fide?* It would not even be strange under the circumstances here if petitioner had not only given half of his business to his children for the purpose of saving it, but had given them the entire business. What father conscious of the welfare of his children would fail to turn his business over to them where otherwise it would go down to destruction? Is a transfer for that reason any the less complete and *bona fide?* The facts here lend no support whatever to such a conclusion.

Respondent's charge is in fact a charge of fraud against petitioner Albert T. Quon. A transfer of assets could indeed be fraudulent, but that charge is not lightly to be made.

> "A charge of fraud has always been regarded as a serious matter in the law. Not only is it never presumed, but the ordinary preponderance of evidence is not sufficient to establish such a charge."
>
> *Kerbaugh v. Commissioner,* 29 B. T. A. 1014, aff'd 74 F. (2d) 749 (C. C. A. 1), 1935.

The facts here give such a charge no shadow of support.

VI.

The Tower Case Itself Shows the Importance, Both Separately and Cumulatively, of Petitioners' Five Points of Distinction From That Case. Those Points Cannot Be Merely Brushed Aside, as Respondent Attempts to Do.

Respondent tries to brush aside the distinctions pointed out by petitioners from the *Tower* and *Lusthaus* cases. With respect to the first distinction, that is, that the donee partners in question here are minor children instead of a wife, respondent cites a number of cases (Br. 18-19), in not one of which is the point discussed whether there is a difference between those relations. Had the facts otherwise in these cases given the taxpayer more support, that issue might have been presented. But nowhere was it even presented.

With respect to the second distinction, that of the presence of a business purpose here, the subject has already been covered above. With respect to the third distinction, the power of any trustee here to withdraw his interest and terminate the partnership, respondent completely evades the issue and discusses wholly unrelated subject matter. With respect to the fourth and fifth distinctions, respondent likewise closes his eyes to the issues. He makes no attempt to meet them, but just brushes them aside.

It must be borne in mind that petitioners did not point out any one of these distinctions as being conclusive in itself, but as being part of a complete picture establishing the *bona fides* of the partnership. If the elements of the *Tower* and *Lusthaus* cases with respect to which these distinctions were made were not important, why did the Supreme Court point them out so clearly and vividly?

VII.

The Recent Belcher Case Cited by Respondent Shows That the Question Is the Broad One of Bona Fides, as Maintained by Petitioners; and That Case's Analysis of Indicia in That Respect in Fact Supports Petitioners Here.

Respondent cites several decisions of the Circuit Court of Appeals for the Fifth Circuit, the most recent one of which is *Belcher v. Commissioner,* decided July 2, 1947. (Br. 17.) In that case the Court presents a rather complete restatement on the entire subject. As the Court there points out, no one factor is controlling. The question is one between reality and fiction, whether or not the partnership was *bona fide* or a mere sham. It points out several factors which may be taken into consideration in that connection. Among them are several which obviously support petitioners here:

1. "Whether the arrangement is between the head of the family and members of his family to whom he owes the obligation of support, and the dominant purpose of the scheme is merely to provide such support and at the same time to divide the income tax consequences among such members of his family";
2. "Whether there have been any proportionate distributions of earnings to the members of the alleged partnership";
3. "Whether the partnership was established merely to be an operating enterprise from which the dominant head kept in himself the title to physical assets of great value that ordinarily would be highly appropriate to the operation";

4. "Whether the power of unfettered command and control over the partnership, its assets, its business, and its profits is retained in, or conferred upon, the family head";

5. "Whether such a partnership interest is unalienable by a partner, or was transferred to him upon condition that he make a will for the return, upon his death, of such interest to his transferor."

Not all of the factors must be considered. The problem, as the *Belcher* case puts it, is to determine whether there are any indicia which demonstrate "the actuality, the reality, and the *bona fides* of the arrangement."

VIII.

The Feldman Case Is in Direct Conflict With the Holding of the Tax Court Here. This Is the Only Conclusion That Can Be Arrived at if We Are to Proceed Logically From the Facts to the Holding of the Court in Each Case.

Respondent in attempting to distinguish the *Feldman* case (Br. 21) really concedes that the citation of that case cannot be answered. He bases his distinction of that case solely on the ground that the trial court there decided in favor of the taxpayer. The Circuit Court there, however, made a complete analysis of the elements in that case which underlay the conclusion of the trial court. (Pet. Op. Br. pp. 13-14.) If the trial court's decision alone had been sufficient, why then that complete analysis? That analysis fully and logically supported the Circuit Court's affirmance. It more than supports the taxpayer here. As shown in petitioner's brief (p. 14), the case here is far stronger than the *Feldman* case.

IX.

There Is No Need for Remand Here to Consider the Applicability of the Clifford Case.

Respondent in a footnote (Br. 12) suggests that if this Court should be of the opinion that the partnership here is a valid partnership for federal income tax purposes it will probably want to remand the case to the Tax Court in order to consider the possible application of the *Clifford* case. For the decision of that issue the record here is complete. As respondent points out (Br. 15), it contains all of the terms of the partnership agreement and of the trust instruments. It contains also the Tax Court's findings with respect to the conduct of the parties in carrying out that agreement. Let respondent show in what respect the record is insufficient to answer the requirements of the *Clifford* case.

Conclusion.

Petitioners submit that the case here is not within the ambit of the *Tower* and *Lusthaus* cases. The distributive share of the trusts in the net income of the Quon-Quon Company should therefore be taxed to the trusts and not to petitioners.

Respectfully submitted,

GEORGE T. ALTMAN,
Attorney for Petitioners.

August, 1947.